DEPARTMENT OF JUSTICE

The Long Road to Local Competition

Statement by

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I appreciate the opportunity to join you here today to offer an overview of how the Department of Justice is assisting in the effort to facilitate competition in local telephone markets. As we have remarked before, this effort is not for sprinters because the enormity of the challenges ahead of us will wear out those who lack the endurance and patience to work through difficult issues and who cannot see more than one hundred yards ahead of themselves. We at the Antitrust Division have learned this lesson the hard way -- through years of work in litigating and then in overseeing the settlement of the AT&T case. Thankfully, the Federal Communications Commission, under the fine leadership of Bill Kennard and four other talented commissioners, recognizes this fact and is taking on the challenge of implementing the 1996 Telecom Act.

If you will indulge me, I would like to take you through the journey that we at the Justice Department have undertaken since the passage of the Act as well as where we see ourselves going from here. My hope here is that if people understand how we view the challenges ahead and how we plan to work through this transition period between regulated monopolies and competitive markets, we will be able to more successfully execute our role in making this Act a success. This transition period, often called the "meantime," is not going to be easy; we are only beginning to see the real benefits of local competition, but are dealing with all of the hassles of unravelling an almost century old system of regulation. We will get through this period and eventually the market for local telephone services will develop so that the incumbent providers and their competitors learn to live together. In this "meantime," however, it is important that we follow the course charted by Congress, which calls for the relevant government agencies to be heavily involved in the local market opening process because the arrangements between the

incumbent monopolists and the new competitors will not simply work themselves out as they would in a free market; rather, because the local incumbents have every incentive to make life difficult for the new competitors, the role of government in facilitating competition is a necessary step along the road to competitive markets.

How We Got Here

In the Telecom Act, Congress recognized that with increased competition in long-distance, exchange access, intraLATA toll, and even in some local markets, the development of competition in local telephony was increasingly feasible, desirable, and all but inevitable. At the time of the Act's passage, however, many states had yet to embrace competition for local telephone service, in part because competition might undermine the old system of cross-subsidies, where certain services were priced above cost to support other services. The Telecom Act addressed this issue and sought to facilitate competition in local telephony primarily through four key provisions: Sections 251 and 252, which set out the framework for local competition, Section 253, which calls for the preemption of any legal barriers to competition, and Section 254, which mandates the development of universal service policies that are compatible with competitive markets. Correlatively, the Telecom Act included another set of key provisions to address the transition away from the last relic of the old Bell System -- the line of business restrictions placed on the Regional Bell Operating Companies that had been divested from AT&T.

We at the Department of Justice heartily supported this Act as the natural culmination of our longstanding commitment that competition could reign in telecommunications under the proper conditions. And, once competition does take root, we envision a new world where the local Bell Companies will be allowed to compete in long-distance services for the first time since they were divested from AT&T, thereby setting up a new dynamic where one-stop shopping services -- i.e., bundled local, long-distance, Internet access, what have you -- will become the wave of the future in telecommunications as both the long-distance and local companies as well as new entrants become full service providers. I understand that many are very impatient for this day to come and take the view that if the government just stepped out of the way, competition could reign. To be sure, Bell Company entry into long-distance will bring more competition to the long-distance market, but unless the local market is first opened, we will not be left with a competitive world of one-stop shopping, but rather the threat of the local Bell leveraging an existing monopoly into a new market. Thus, in a bit of irony often misunderstood by those of us not living with the challenging task of overseeing a very significant, and challenging, industry restructuring, there are a number of regulatory steps that must be taken to move a long-regulated industry into a competitive environment.

To fulfill the Act's mandate that the Department evaluate the competitive dynamics regarding Bell entry, the Department adopted -- after a long consultative and extensive internal review process -- the "fully and irreversibly open to competition" standard. This standard has been explained in numerous speeches, congressional testimony, an affidavit by our expert economist, Marius Schwartz, that we have included with each of our section 271 filings and,

most significantly, in our evaluations of the four section 271 applications filed thus far. In short, our approach looks to the state of marketplace, the development of the essential wholesale inputs, and the implementation of performance measurements and protections against backsliding in order to determine whether or not the market is fully and irreversibly open.

While a visit to the Division's web-site can further elucidate what we mean by "fully and irreversibly opening" the local market, let me highlight four issues for you here today that we have determined to be particularly important. First, we believe that the essential wholesale inputs that new entrants will purchase from the incumbent provider must be available at a forward looking price that is reliable; by this we mean that the prices charged for unbundled loops, number porting, collocation, etc., must be based on some notion of economic or forward looking cost as well as some stable methodology that will provide assurance that these prices will not change willy-nilly. In short, our view is that a cost structure for important wholesale inputs that is a moving target or based on inflated (i.e., backward looking) costs is an effective way of deterring local market entry; and if local market entry is impracticable, then our view is that the local Bell Company should not be permitted to enter into the market for in-region long-distance services.

The second essential part of our analysis focuses on the development of appropriate wholesale support systems, most notably the operations support systems -- or computer interfaces -- that will support seamless switching of customers and enable the new entrants to compete on a level playing field with the local incumbent. If adequate systems are not available,

local market entry will be deterred, impeded, or both. In essence, the core aspects of receiving telephone service -- the availability of dialtone, the awareness of different features, the receipt of accurate bills, and so on -- all stem from the operations support systems relied upon by the local incumbent and the new entrant. I have heard some question why we are so focused on these systems, noting that nowhere in the Act is the word "operations support systems" mentioned. The answer is quite simple: these systems are inherent in so much of what the Act commands be available on a non-discriminatory basis, such as access to network elements unbundled from the local network or resold telecommunications services.

To understand the importance of these systems, put yourself in the shoes of a would-be entrant in the local market. To be successful, you have to be able to switch a customer from the incumbent to your company without delay, service outages, or the receipt of multiple bills. And, if inadequate systems provided by the incumbent are to blame for these problems, the customer is not going to want to hear excuses, but rather will wish to go back to the way it was before, where he or she experienced no such difficulties. To be sure, systems development issues arise on both sides and will often take the cooperative efforts of all involved -- not just the incumbent Bells -- to be solved adequately. Thus, where new entrants are not likely to be ready -- for whatever reason -- to stress test certain systems, we are prepared to assess their adequacy through other means, such as independent, third party testing.

The third area that we are focused on is the development of a structure where a Bell Company, once in the long-distance market, will not be able to "backslide" on wholesale

performance without paying a price. This structure entails four sub-parts: performance measurement, reporting requirements, performance standards, and penalties for deficient performance. Let me explain each in turn.

The first part of guarding against backsliding is to ensure that the performance measures that we believe to be necessary -- i.e., which address all important areas of wholesale performance -- are instituted by the incumbent so that the incumbent can generate regular reports on its wholesale and retail performance in certain areas. (In this regard, Don Russell, the chief of our telecommunications task force, recently sent a letter, which has been made publicly available, that sets out a list of measures that we regard as adequate for SBC to satisfy our standard for section 271 entry.) Second, the local Bell must demonstrate that its performance reports comport with appropriate reporting requirements so that the reports are meaningful and accurate. For example, a Bell Company may need to provide disaggregated performance results between business and residential customers or between different geographic areas if that will be necessary to make meaningful comparisons. Third, a Bell Company will need to have performance standards in place to serve as a benchmark for post-entry performance. In many cases, the retail analogue to the wholesale service -- say, the time taken to provision a telephone line -- will be the best "apples to apples" comparision; as the FCC's Local Competition Order clearly explained, this parity standard is what the Act demands. Where there is no retail analogy to a wholesale service, an objective standard, say, an interval for provisioning unbundled loops, will need to be developed.

The fourth aspect of guarding against backsliding is that we expect Bell Companies to be held liable -- through contractual remedies, state regulatory oversight, and at the FCC -- for deficient performance. And such remedies must not be so lenient that they can simply be viewed as a cost for doing business. Thus, we at the Justice Department believe that a particularly important part of section 271 is the threat of halting future long-distance marketing authority for deficient wholesale performance, which we will not hesitate to ask the FCC to use should post-entry developments so warrant.

The final critical aspect of our standard is the importance of enabling unbundled elements to be employed successfully, either individually or in combination. The legal uncertainties around this issue have made it especially challenging, but the use of unbundled elements is an important entry vehicle created by the Act, particularly for residential customers. Eventually, as new developments, such as technological breakthroughts in cable telephony or wireless technology take hold, we may see longer term solution to the challenge of competing in "the last mile," but, for the foreseeable future, the use of combinations of and individual unbundled elements will be an essential part of making this Act a success.

The Value of Guidance: An Open, Constructive, and Engaged Process

Since the enactment of the Act, the Department's view has been that explaining what would meet our standard could serve several important purposes. For the entrants in the local market, some measure of predictability concerning what they can expect from their most important wholesale supplier, the local Bell Company, will make it easier for them to make the

business and investment decisions related to local market entry. For the local Bell Companies, the most frequently articulated concern is that the local market opening process is only about making investments to enable competitors to serve their best customers without any real expectation that these investments will pay off in the form of section 271 entry into long-distance. Both the entrants and the Bells can thus concur with one basic point: a clearer understanding of the ground rules of local competition will enable each to make more informed business decisions and, in the case of the Bell Companies, to decide how quickly to open up fully their local markets. And, where a Bell Company, once aware of our standard, decides that it is interested in complying with it, we believe it is constructive for us to roll up our sleeves to work with all interested parties to assess whether a proposed approach will satisfy our standard in light of the specific circumstances of a particular state.

As we move forward in this process to apply our standard to particular states, we intend to work with any and all interested parties and, where a state commission is interested, we have found that sharing information and our views with the state commission can also improve the local market opening process. Thus, right after the Telecom Act was passed, Anne Bingaman, the Assistant Attorney General at the time, took the important step of appointing a liason to each of the regions to keep up with local consumer groups, state commissions, new entrants, and the local Bell. I believe that this effort has been successful thus far and if any of you are interested in touching base with the appropriate person, you should be sure to contact Don Russell at the Telecommunications Task Force.

The New York Workplan

Before the Telecom Act was passed, the Department developed a plan -- through consultation with a wide range of interested parties -- under which Ameritech would agree to take a number of steps that, if successfully implemented, could lead to their entry, on a trial basis, into long-distance markets in some portions of Illinois and Michigan. Under the AT&T consent decree, the Justice Department, as the plaintiff in the case, was in a special role that allowed it to work out such a plan and propose it to the district court. The leadership shown by Department in mapping out this framework was an important step for competition both in and of itself as well as in outlining some of the important market opening measures for Congress, as it developed legislation, and for states that were interested in opening their local telephone markets to competition. Indeed, some have suggested that this very leadership helped the Department get a similar role under section 271 to the one that it had under the consent decree -- with the FCC, like the antitrust court before it, according "substantial weight" to the Department's analysis of Bell entry.[1]

Following on in the tradition of the plan worked out with Ameritech, the Department is similarly willing to comment on a "workplan" filed by a Bell Company with its local state commission, such as happened recently with respect to Bell Atlantic in New York. In many respects, our willingness to comment on a workplan rests on the same basic motivation behind

[1]Compare 47 U.S.C. §271(d)(2) (requiring FCC to accord "substantial weight" to Justice Department evaluations of section 271 applications) with United States v. Western Elec. Co., 900 F.2d 283, 297-98 (D.C. Cir. 1990) (per curiam) (Justice Department entitled to "substantial deference" on evaluations of proposed waivers under the AT&T consent decree).

our efforts to explain what our standard demands in the way of, say, operations support systems and performance measures. In both endeavors, I expect that people recognize that some assurance on a template is a far different matter than judging an actual application for section 271 authority. Put more simply, we will not reach any definite conclusion about a particular section 271 application until the actual filing, as we find it crucial to examine the specific comments and state of the marketplace at that time. That being said, I do believe that pre-filing processes, such as the filing of a workplan and the hearing of evidence and comments by state commissions in advance of the application filed at the FCC, have been very important in helping us to focus on the most central issues affecting the development of local competition.

For those of you who are unfamiliar with it, I recommend that you examine the workplan developed under the leadership of the New York State Public Service Commission. In so doing, however, it is essential to be mindful that this plan is only one model -- both substantively and procedurally -- of how to get a local market open to competition. As is becoming increasingly clear, different state commissions face different circumstances and will approach the opening of the local telephone market in different ways and we, as a supporting player in this process, will work with the situation as we find it. We certainly have views about important aspects of opening the local market, such as the need for post-entry enforcement, but there are also a range of possible approaches that are consistent with our basic standard and the state of the law. Thus, depending on the actions taken by the state commission, the particular conditions in a given state, and ensuing legal developments, there may well be different frameworks that could also accomplish the essential task of opening up the local market.

As we have noted before, it is important for those of us involved in this process to appreciate the challenges posed by legal change as we move forward to implement the Act. With respect to the question of how competitors can get access to unbundled elements to be used in combination, for example, we believed that the FCC had adopted a very sensible approach that required the incumbent providers not to separate, except upon request, network elements that the incumbent already has in combined form in its network. The Eighth Circuit disagreed with the FCC's view on this issue and declared that such elements may be made available in a separated form so the competitors could combine them for themselves. The Eighth Circuit did not, however, explain just how this job could be accomplished, so the FCC, the States, and the Department were left to devise an appropriate approach for addressing this very complicated issue. While we have yet to fully work through this issue in the wake of the Eighth Circuit's decision, we do know that unbundled elements must be offered in a manner in which competitors can combine them without enduring discrimination, unnecessary costs, or other impediments to using this important entry vehicle.

Over time, different states are likely to develop different approaches to how network elements will be combined and we will continue to evaluate what will be consistent with our standard. Thus, in the New York workplan for example, Bell Atlantic addressed this issue by a commitment that competing carriers will have reasonable and nondiscriminatory access to unbundled elements in a manner that gives those carriers a practical and legal ability to combine them. As Bell Atlantic goes forward to implement that commitment, we think it will be important to identify the most efficient methods for competitors to combine unbundled elements

so as to minimize the unnecessary costs that may result from the Eighth Circuit's interpretation of section 251(c)(3) of the Act. Indeed, the very fact that the Eighth Circuit's ruling imposes these unnecessary costs is why we have argued to the Supreme Court that this ruling threatens to undermine one of the Act's most "pro-competitive tools"[2] and should be overruled.

As many have recognized, identifying what steps are necessary to fully and irreversibly open the local market is an important step along the way to local competition. Thus, we believe it is important for us to be willing to roll up our sleeves, look at local conditions, and focus on what conditions are necessary to getting the local market opening job done right. How long it will take Bell Atlantic, with the benefit of its workplan, to actually, fully, and properly implement the necessary steps remains to be seen, but at least now Bell Atlantic and the local competitors in New York will be able to envision the type of wholesale services that we believe will enable competition to take root. There is still much important work to be done in New York -- in terms of ensuring the adequacy of Bell Atlantic's systems, performance measurement processes and the ability for competitors to combine unbundled elements, among others -- but there is also a helpful structure and process in place to guide this work. As we have made quite clear, Bell Atlantic will not get the Department's support unless it satisfactorily implements, and documents in its application, the necessary market opening steps. But, if Bell Atlantic does satisfactorily implement and document those steps, we will then see what good things can happen when a local telephone market is finally opened to competition and the companies can

[2] See Federal Communications Commission v. Iowa Utilities Bd., No. 97-831, pet. for cert. at 26 (Nov. 17, 1997).

have at it in the marketplace in a fair fight for one-stop shopping of local and long-distance services.

Conclusion

The transition from regulated monopoly to competitive markets in local telecommunications services, though not as rapid as most of us would like, is already well underway because of the powerful dynamics unleashed by the Telecommunications Act of 1996. Most importantly among these dynamics is the role that market forces and technological change will play in moving the industry away from regulated outcomes to competitive possibilities. As I noted at the outset, we in government must understand what role we have to play in the process, and when we need to simply step back and watch events unfold. At this point in time in particular, I believe that the governmental agencies have an important role to play in ensuring the operation of the market by enabling the new entrants into the local market to get access to the local monopolist's network in accordance with the terms set forth in the Act. Once competition really begins to take root, a lighter hand will eventually be appropriate, but in the near term, no monopolist is going to make life easy for competitors unless the essential regulatory carrots and sticks are working to ensure that they take the necessary market opening steps.

The Antitrust Division is committed to playing its part in the pro-competitive process spawned by the Telecom Act and, wherever appropriate, we will explain to interested parties what our standard demands. Unfortunately, even if all of the relevant players all do their part to facilitate competition, no one should think that the race for local competition will be one for

sprinters, as getting the necessary arrangements in place -- economic, technical, and legal -- will take time in the best of all possible worlds. But this race is worth running because it is one of great promise, for if competition can be brought to all telecommunications markets, consumers will be rewarded with the benefits that they have enjoyed in other markets -- more choice, improved quality, better prices and enhanced service offerings.